Testimony

on

The Size of Surpluses Remaining after the 2001 Tax Cut

by

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Committee for a Responsible Federal Budget

The Committee for a Responsible Federal Budget is a private nonprofit educational organization dedicated to educate the public about the Federal budget, the budget process and other issues that may have macro economic impacts. Located at 220½ E Street Northeast, Washington, DC  20002. Telephone (202) 547-4484.  Fax (202) 547-4476. Email crfb@aol.com.

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Mr. Chairman, Senator Domenici, Members of the Committee, thank you for inviting us to testify today.

Having so often sounded like a scold, I would like to begin by congratulating both the new Chairman and the former Chairman (now Ranking Member).

Senator Domenici is to be congratulated for putting together a bipartisan budget in difficult and unique circumstances—

- A 50/50 Senate
- A new President; and
- Against the backdrop of huge surplus projections.

Even those who do not agree with the policy or the process admire your persistence and determination.

We congratulate you, Chairman Conrad, on your commitment and determination to enforce the budget resolution. No Congressional leader, Democrat or Republican, in the House or Senate has faced a similar dilemma since Speaker Tip O'Neill in 1981. Like you, the Speaker opposed the budget resolution. Like you, he questioned the wisdom of the policies embodied in the resolution. Also like you, the Speaker took the position that once Congress passed a budget he was duty-bound to enforce it.

Understanding that you and your leadership opposed the resolution, we want to take this opportunity to express our admiration for your commitment to fiscal discipline and the budget process.

You ask, how large is the remaining budget surplus? Our first reaction is that Congress and the Administration left too much money on the table in Fiscal Year 2002. Attachment 1 is a table that illustrates the problem. The on-budget surplus (with or without HI) is larger in FY 2002 than in any other year until FY 2006.

This summer's re-estimates may help. That is to say, if the August re-estimates they may reduce the projected surplus for next year more than they reduce the projections for FY 2003-FY 2005 they could produce projection patterns more amicable to sensible policy choice. Unless you plan on another tax rebate next year, we fear that this pattern could bode badly for the years between 2002 and 2006.

Rudy Penner, a Member of our Board of Directors, well respected economist and former CBO Director is the author of *Errors in Forecasting.*[1] Under the heading, *The Usefulness of Flawed Forecasts,* Rudy writes—

[1] The Urban Institute, Washington DC, April 2001

“It has been shown that forecasts become rapidly less reliable as the forecast period is extended. Forecasts for periods beyond five years are not totally misleading, but it would be foolish to believe that they provide anything but the crudest indication of the nation’s fiscal health. Given constant policies, the surplus for 2011 was projected in January 2001 to be $889 billion or 5.3 percent of GDP. There is, however, a good chance that the final outcome could be twice that figure or zero, even without policy change.

“On the other hand, there is only the tiniest possibility that 2011 could see a deficit in the range experienced between 1982 and 1986, when the unified deficit varied between 4.0 and 6.1 percent of GDP. Although the uncertainty is enormous, the estimates indicate that the nation’s budget is very likely to remain healthy or at least not become extremely unhealthy for the next 10 years.”

Under the heading, *Congress should devote more effort to analyzing the risks of outcomes that may occur because the forecast is wrong,* Rudy writes—

“As noted above, it now appears highly unlikely that we will return to the dangerous deficits of the 1980’s even if current projections turn out to be overly optimistic. In contemplating tax cuts or spending increases, Congress faces a more symmetrical set of risks. If it avoids a major tax cut and the projections become consistently more optimistic, the nation will not have the increase in private consumption that otherwise might have been enjoyed. If Congress passes major tax cuts and the projections become more pessimistic, the nation may not save as much as it should, given the approaching retirement of the baby boomers. In particular, future surpluses may fall short of the surplus in the Social Security trust fund—a goal not enunciated by the majority of Congress.

“There may be a slight asymmetry of risks, in that it is probably somewhat easier to cut taxes and increase spending if projections become more pessimistic. However, Congress did manage to raise taxes and restrain civilian spending during the 1980’s, and how they should be balanced is much less apparent.

“Because of the currently superb fiscal situation, it should also be emphasized that the risks of being wrong are not very large. If between now and 2011, $1 trillion less in debt is retired than planned, interest payments will be $50-$60 billion higher than anticipated, representing about 2.5 percent of outlays. Economic growth will be minutely lower, but if the shortfall is not the result of slower-than-anticipated growth, consumption will be higher in the interim. The effect on the nation’s well-being will be trivial relative to the $17 trillion GDP expected in 2011. If the shortfall is the result of lower-than-anticipated growth, it is appropriate to lower the target for the surplus in any case. The lower growth will cause a significant loss of welfare, but the fiscal policy mistake will not.”

Simply reviewing the facts leads us to two conclusions—

1. Governments save by retiring debt, but we do not put money in a piggy bank. The money (except for interest savings) will not be available to pay program costs in future years. Reducing debt today may make it easier to borrow in the future, but it does not create budgetary resources to meet public service needs in future years (except of course for the interest savings).

   Reducing debt held by the public by $1 trillion less than current plans would increase interest costs in 2011 by $50-$60 billion. Make no mistake, $50-$60 billion dollars is serious money. And there is a very real trade-off between interest costs and funds available for programs. But the interest saving is all that we gain in budgetary terms by retiring debt held by the public.

2. It is very easy to lose track of the sheer magnitude of the numbers we are throwing around in our current budget debates. Simply using the Social Security trust fund surplus to retire debt, will reduce debt held by the public by amounts greater than the entire budget of the State of California each year—and by amounts greater than the GDP of some pretty good size countries, such as Columbia or Saudi Arabia.[2]

   Budget resolutions and budget enforcement require a baseline—a benchmark or point of departure. Baselines cannot and should not change with every daily or weekly economic report. Given the magnitude of current surplus projections, any adjustments that may be made this summer likely will seem trivial in the overall scheme of things. [And as we remarked at the top of this testimony, if those changes diminish the FY 2002 surplus relative to FY 2003-FY 2005 they may actually prove to be helpful.]

   The budget resolution now in place provides the needed benchmark for tracking legislation. Sure, the numbers will change. But sanctioning change too frequently or at intervals too close can only lead to further criticism and confusion. In the House Budget Committee hearing yesterday there was a lot of kidding about “back of the envelope” and “cocktail napkin” re-estimates—and we confess to a little bit of that when we constructed the table at attachment 1. But you should stick with the resolution for purposes of budget enforcement. You simply cannot use “back of the envelope” or cocktail napkin” forecasts and projections for enforcement purposes.

[2] See attachment 2 for a list

Many Members and staff already believe that the budget process is confusing and lacks transparency. Given your commitment to strong budget enforcement, Mr. Chairman, anything you can do to make the process seem more stable and more understandable probably will make your job easier.

There have been some notable successes enforcing the resolution in the month or so since its adoption.

- We are not crazy about the way they did it, but the tax-writers kept the tax bill within the limits in the resolution.

  Many will decry the sunsets and delayed implementation of some popular provisions in that bill as old-fashioned gimmickry. But, if you dislike the policies underlying the tax cut and/or if you are concerned about future shortfalls, you should welcome the sunset provisions. Congress must act and the President must sign one or more new laws, or else revenues rise compared to current projections.

- The supplemental follows the budget resolution. For the first time in years, a Presidential request for supplemental appropriations has not become a Christmas tree with all the trimmings.

- The House Agriculture Committee last week held the line on the $5.5 billion assumption in the budget for additional farm assistance this year.

  Representatives John Boehner (R-OH), Saxby Chambliss (R-GA) and Charley Stenholm (D-TX) 6and most of the Democrats on the Committee deserve credit for that action. Chairman Combest opposed them, but he supported the Committee bill on the floor and it passed the House on suspension. We only hope that the Senate will follow their lead.

The Senate could bet to the supplemental and the President could sign it before June 28th when we are due to deliver this testimony. But as we write, the tax cut is the only policy assumed in the resolution that actually has been enacted.

The budget resolution assumes new spending policies that total more than $530 billion. The Budget Committee Chairman has wide discretion to release money for various policies assumed in the resolution—

- $300 billion for prescription drugs;
- $28 billion for health insurance for the uninsured;
- $8 billion for Family Opportunity Act;
- $14 billion for home health; and
- $66 billion for agriculture.

Release of these amounts by the Chairman will impact greatly the fiscal path pursuant to the budget resolution. It may impact even more on the longer-term outlook. Thus, the Budget Committee Chairman has considerable latitude to influence final budget outcomes this year.

The table at attachment 1 shows three different budget surplus calculations—

- Total (or consolidated or unified) surplus;
- On-budget (non-Social Security) and off-budget (almost entirely Social Security) surplus; and
- On-budget surplus less the HI surplus.

From an economic perspective, the total surplus is the only really meaningful number. The actual unified budget surplus will determine the amount by which we reduce debt held by the public. It measures the impact of the Federal government on the entire economy.

The off-budget (shorthand for non-Social Security) surplus has proven to be very useful. Aaron Wildavsky used to write a lot about the norm of budget balance. Given very large and growing actual and projected surpluses, the norm of budget balance does little to restrain fiscal policy choice or impose budget discipline.

But the proposition that we should "save Social Security surpluses", i.e., use those amounts to retire debt held by the public, has very broad and deep political appeal. Congress and the President have all but adopted blood oaths to the effect that you will save Social Security surpluses for Social Security. That has proven a very useful firewall from the perspective of those of us who support debt retirement. As noted above, "saving Social Security surpluses" would reduce debt by amounts larger than the total budget of any State in the nation and the GDP of many large countries. Devoting all Social Security Trust Fund surpluses to that purpose would allow the Treasury to buy back all the debt that available to retire before the end of the decade. There may be no specific economic import to the number, but the policy outcome certainly is a welcome one.

The HI surplus is the new kid on the block. The need to “save Medicare surpluses” is floated by some as a proxy for the argument to reduce debt more and faster than would be the case if we used only Social Security surpluses for that purpose.

Reducing debt more may indeed be a better policy—but we do not expect it to happen. We believe—when all is said and done—Congress and the President will compromise on policies to commit the entire non-Social Security Trust Fund surplus. We fear for the political party that first argues that something else is more important than saving Social Security, but we doubt that the HI surplus prohibition will prove to have the same staying power.

The budget resolution made it very clear that Congress cannot pass policies that would dip into the HI Trust Fund surplus unless you make an explicit decision to do so.

It seems clear to us that the budget resolution allows you to use Medicare surpluses to pay for Medicare reform. Indeed, you may want to do so. Anything Congress does in the short term that helps to narrow the long-term gap between dedicated receipts and benefit commitments in Medicare would be a solid investment in future fiscal sanity.

It seems to us that there is more than enough money to pay for the policies assumed in the resolution (certainly in the budget year) without diminishing the HI surplus. And the Chairman has extraordinary power help ensure that outcome.

On the other hand, a prescription drug benefit in the absence of Medicare reform is a bad idea—not because it may use up part of the HI surplus in the short term. Adding prescription drugs to the current Medicare program would only make an already unsustainable program more expensive. And the Medicare dilemma already is more difficult than the Social Security problem.

Our organization believes that universality; transparency and accountability define responsible budgeting. There is no objectively right level of Federal spending and revenues. We believe that Congress should abide by the budget or act constructively to change it. You should not cut taxes below, nor increase spending above the budget without first amending the resolution.

We are concerned that Congress and the President have not acted to write into law appropriations caps for the balance of this Congress. WE understand that some Members hate the thought of voting for a cap one cent higher than the $661 included in the budget for FY 2002. We also understand that some Members want to know more about the President's request before agreeing to new appropriations caps. And we understand that some think $661 is too little, period.

For those committed to fiscal discipline and the integrity of the budget process, we have this advice. The sooner you write caps into law the less you will spend in the aggregate and the more discipline you will bring to the appropriations process.

We understand the reluctance to add caps to the supplemental due to the 60-vote majority that would be required. But who is kidding whom? If you cannot muster 60 votes for the new caps in the Senate, you probably cannot enforce them in any case. We urge the Chairman and the Ranking Member to get together with one another—with your House counterparts and whomever else you think it is necessary to strike a deal you can enforce—and move legislation to enact new caps for the balance of this Congress at the earliest possible moment.

This could be a critical step toward restoring faith in the budget process even as it could test the commitment of the Congress and the President to fiscal restraint.

In closing, we don't really think that the pending debate is about saving money. We are convinced the debate is about how to spend. We think and hope that you can hold the line and actually use Social Security Trust Fund surpluses to retire debt. We will be very surprised (albeit pleasantly) if actual debt retirement exceeds those amounts. So the sooner you force a debate and vote on how much is too much to spend for appropriations, the sooner the Chairman will have a clear idea how much is left for everything else. And he has an extraordinary degree of latitude to keep spending within the amounts available in the budget this year.

Thank you again for the opportunity to testify today. I am happy to take any questions that you may have.

## Budget Status Report—June 1, 2001

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2002-06 | 2002-11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Surplus** | | | | | | | | | | | | | |
| CBO March Baseline | 275 | 304 | 353 | 400 | 437 | 508 | 578 | 641 | 718 | 806 | 883 | 2002 | 5629 |
| Off-Budget | 156 | 172 | 187 | 202 | 221 | 238 | 256 | 275 | 293 | 311 | 330 | 1020 | 2487 |
| On-Budget | 119 | 132 | 166 | 197 | 215 | 270 | 322 | 366 | 425 | 495 | 553 | 980 | 3142 |
| HI | 28 | 38 | 41 | 43 | 42 | 45 | 43 | 42 | 40 | 36 | 28 | 209 | 397 |
| On-Budget-HI | 92 | 95 | 125 | 155 | 173 | 225 | 279 | 324 | 385 | 459 | 525 | 773 | 2745 |
| Tax Cut | | | | | | | | | | | | | |
| JTC Estimates | -74 | -38 | -91 | -108 | -107 | -135 | -152 | -160 | -168 | -187 | -130 | -479 | -1275 |
| Debt Service* | 2 | 5 | 8 | 14 | 21 | 29 | 38 | 49 | 61 | 74 | 87 | 77 | 385 |
| Surplus effect | -76 | -43 | -99 | -122 | -128 | -164 | -190 | -209 | -229 | -261 | -217 | -556 | -1660 |
| Remaining Surplus | | | | | | | | | | | | | |
| Total | 200 | 261 | 255 | 278 | 309 | 345 | 388 | 432 | 489 | 545 | 666 | 1448 | 3968 |
| On-Budget | 44 | **90** | **67** | **75** | **87** | **106** | 132 | 157 | 196 | 234 | 336 | 425 | 1481 |
| On-Budget-HI | 16 | **52** | **26** | **33** | **45** | **62** | 89 | 115 | 156 | 198 | 308 | 218 | 1085 |

*Based on CBO Estimates
Prepared by the Committee for a Responsible Federal Budget—June 2001

Attachment 2

Selected Countries with GDP less than US Social Security Trust Fund Surpluses

Chile
Columbia
Egypt
Finland
Greece
Hong Kong
Indonesia
Iran
Ireland
Israel
Malaysia
New Zealand
Pakistan
Peru
Philippines
Poland
Portugal
Saudi Arabia
Singapore
South Africa
Thailand
Venezuela